

Whitepaper

To Screen Or Not To Screen

Donor Screening In The Age Of Financial Crimes



Table of Contents

Introduction	02
Donor Screening: An In-Depth Look	03
Regulatory Landscape	03
Case Study: UK Regulatory Landscape - "Know Your Donor" Guidelines	05
Challenges in Donor Screening	08
Comprehensive Risk Mitigation Strategy	09
The Role of Technology in Implementing Risk-Based Approach and Risk Analysis	10
What should be your plan of action?	12

Introduction

"I shall take it with me; for it will be better used for charity and the good of my merry band than in the enriching of such knaves as these."

In "The Merry Adventures of Robin Hood," Robin Hood speaks these words to himself after prevailing over the four beggars who feigned illness to get alms, managing to successfully acquire their money.

Robin Hood has been a timeless figure in classical literature.

After all, who doesn't love an underdog who steals from the rich and helps the poor? Regulatory bodies dealing with financial crimes in the 21st century, that's who.

In a world marked by terrorist financing, financial crimes, and opportunists aiming to exploit non-profit organizations for their malicious, and sometimes outright harmful, purposes, it is imperative for charitable entities to remain vigilant. Regulatory bodies play a crucial role in ensuring that NPOs are not exploited or transformed into fronts for illicit activities. The existence of anonymous donations introduces an additional layer of complexity to these challenges.

Consequently, donor screening has become of paramount importance in navigating this sensitive landscape.



Donor Screening: An In-Depth Look

Definition:

Donor screening refers to the process of evaluating and vetting individuals, organizations, or entities that intend to make donations to a cause, particularly within the context of non-profit organizations (NPOs) or charitable activities.

Objective:

The **objective** of donor screening is to assess the legitimacy, credibility, and potential risks associated with the donor to ensure that the funds or contributions received align with the values, goals, and legal obligations of the receiving organization.

Process:

This **process** often involves verifying the identity of donors, assessing the source of funds, and identifying any potential connections to illegal or unethical activities, such as money laundering, terrorist financing, or other financial crimes. Donor screening is a crucial component of risk management and regulatory compliance for entities involved in charitable work or fundraising.

Regulatory Landscape

In today's tumultuous economic landscape, further exacerbated by external shocks such as global pandemics, regional conflicts, and poverty, the work carried out by Non-Profit Organizations is not only essential but also needs to be executed swiftly and with minimal hassle. Amid these challenges, efficient and cost-effective donor screening becomes a pivotal process for ensuring the sustained impact of NPOs in addressing pressing societal issues. Given that NPOs heavily rely on the generosity of their donors, it is logical for donor screening to be conducted efficiently and cost-effectively.

Ensuring a streamlined donor screening process not only enhances operational efficiency but also safeguards the integrity and trustworthiness of the funds supporting these critical endeavors. This strategic approach, rooted in transparency and accountability, enables NPOs to proactively identify and mitigate potential risks, fostering stronger relationships with donors. It allows organizations to focus more effectively on their humanitarian missions, addressing pressing issues and making a meaningful impact on the communities they serve.

As FATF has stated in the report titled, *Combating the Abuse of Non-Profit Organisations*:

“While it is vital to protect NPOs from terrorist abuse, it is also important that the measures taken to protect them do not disrupt or discourage legitimate charitable activities, and should not unduly or inadvertently restrict NPO’s ability to access resources, including financial resources, to carry out their legitimate activities.”

However, the question arises: should all NGOs be concerned with donor screening, or is it only necessary for specific NGOs operating in particular sectors? FATF Recommendation 8,¹ along with the 2014 FATF report, identifies specific NGOs that are particularly susceptible to terrorist financing and money laundering. Consequently, a natural corollary is that donor screening is crucial for these sectors.

The sectors highlighted by the FATF report are:²

- ▶ NPOs most susceptible to terrorist financing are those involved in "service activities," such as housing, social services, education, or health care, according to the FATF definition. Notably, none of the analyzed case study NPOs engaged in "expressive activities," like sports, recreation, arts, culture, or political advocacy.

- ▶ Among NPOs engaged in service activities, the level of risk varies, with a higher risk for those operating "in close proximity to an active terrorist threat." The key factors determining higher risk are the value of NPO resources to terrorist entities and the proximity to an active terrorist threat capable of exploiting NPOs.

However, this does not imply that all other sectors are exempt from donor screening. The report identifies the most high-risk sectors vulnerable to a specific type of crime, namely terrorist financing and money laundering. These sectors should exercise heightened vigilance regarding donor scrutiny.

1. (n.d.). FATF. Retrieved February 9, 2024, from <https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/BPP-combating-abuse-non-profit-organisations.pdf>

2. RISK OF TERRORIST ABUSE IN NON-PROFIT ORGANISATIONS. (2014, June 18). FATF. Retrieved February 9, 2024, from <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Risk-of-terrorist-abuse-in-non-profit-organisations.pdf.coredownload.pdf>



Case Study:

UK Regulatory Landscape - "Know Your Donor" Guidelines

- ▶ The trustees of charitable organizations are obligated to exercise due diligence in understanding the sources of their funds. While not every donation requires exhaustive scrutiny, trustees should be particularly vigilant when dealing with substantial sums or when circumstances surrounding the donation pose notable risks.
- ▶ The overarching goal is to assess potential risks to the charity associated with receiving specific donations and to ensure their appropriateness. Due diligence serves several purposes, including evaluating the legitimacy of the donation, confirming that it does not originate from illegal sources, and understanding any attached conditions.
- ▶ Trustees must also ascertain the identity of donors, especially in the case of significant contributions, taking reasonable steps to verify this information when necessary. For smaller, routine donations or those collected in public appeals, detailed scrutiny may not be practical or required. However, maintaining records, particularly for Gift Aid claims, is essential, aligning with legal obligations under the Data Protection Act 1998.
- ▶ Legacies from wills warrant careful receipt procedures, ensuring clarity with executors and obtaining necessary details. In cases of substantial grants or close relationships with donors, additional due diligence becomes crucial. Trustees may need to investigate the background of donors, especially if concerns have been raised about their activities or if they operate internationally.
- ▶ Anonymous donations are permissible, provided charities remain vigilant for suspicious circumstances and adhere to local laws and tax regulations when operating abroad. Conditions attached to donations are acceptable as long as they align with the charity's purposes and are not illegal. However, if conditions threaten the charity's independence, trustees may need to consider refusal.

► Identifying suspicious donations involves recognizing unusual features, requiring trustee training and established policies. Uncovering criminal evidence during due diligence mandates immediate reporting to the police, with clear procedures for serious incidents reported to the Charity Commission

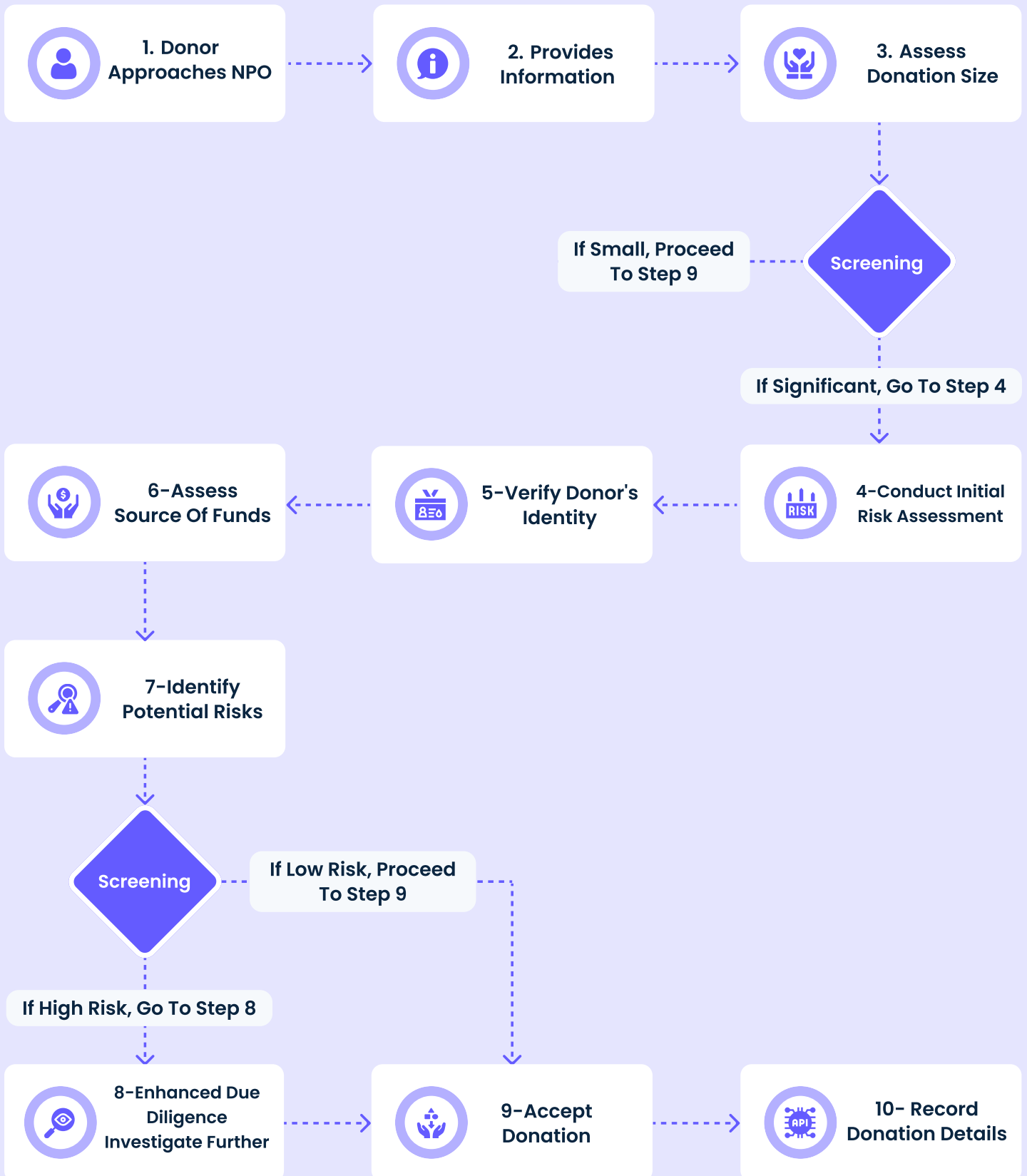
► Understanding the tax treatment of substantial donations is crucial, and charities must comply with legislation, such as the Finance Act 2006, to prevent potential abuse. Failure to scrutinize donations adequately may lead to legal, reputational, and operational consequences for charities.

Note: Finance Act 2006³

“Chapter 4 of the Finance Act 2006 introduces Section 506A of the Income and Corporation Taxes Act (ICTA) 1988, outlining specific transactions involving substantial donors and charities. It covers various scenarios, such as property transactions, services, financial assistance, and investments. A substantial donor is defined based on relievable gifts received, and non-charitable expenditure terms are addressed, with relief disallowed if less favorable than arm's length. Section 506B provides exceptions, considering factors like business involvement. Section 506C details regulations, emphasizing relievable gifts. The chapter amends Section 505, emphasizing charitable expenditure, and introduces changes to trade profits and gift aid relief. Lastly, it extends restrictions on gift aid payments by companies, with amendments effective from April 1, 2006.”

3. Compliance Toolkit: Protecting Charities From Harm – ‘Chapter 2: Due diligence, monitoring and verifying the end use of charitable funds’. (n.d.). GOV.UK. Retrieved February 7, 2024, from <https://assets.publishing.service.gov.uk/media/5a81d2deed915d74e34003f9/Chapter2new.pdf>

Donor Assessment Flow



Challenges in Donor Screening

Resource Constraints

Smaller organizations face challenges due to limited resources, including outdated technology, insufficient staff training, and financial constraints. Outdated or inadequate screening systems hinder their ability to thoroughly analyze donor information in real time. The shortage of skilled personnel, combined with budgetary restrictions, makes it difficult to provide adequate training for navigating the complexities of donor screening. Financial limitations also impact their ability to invest in advanced screening technologies or hire dedicated personnel to oversee screening processes effectively.

The Risk of Politicization

There is a significant risk of politicization arising from the exploitation of improper donor screening. With the surge in political polarization and the emergence of populist regimes, there is a tangible threat of leveraging AML/CFT laws to coerce non-profit organizations into compliance with the government's agenda. While much responsibility lies with legislators, civil society—comprising human rights organizations and civil liberties groups—NPOs, having some control, can safeguard against government intimidation tactics by ensuring thorough and foolproof donor screening processes. This proactive approach is essential to maintaining autonomy and resisting potential interference.

False Positive

False positives in donor screening systems arise when legitimate donors are mistakenly identified or flagged as potential risks by the screening process. This can happen due to various factors, such as similarities in names or addresses to individuals or entities on watchlists, outdated information, or algorithmic limitations. While the goal of donor screening is to identify and mitigate potential risks, the occurrence of false positives highlights the need for organizations to fine-tune their screening mechanisms to enhance accuracy.

Cross-Border Transactions

Organizations that operate internationally or receive donations from foreign entities must navigate the complexities of cross-border transactions. This complexity is rooted in the diverse legal and procedural requirements set forth by different jurisdictions, contributing to the multifaceted landscape that organizations must navigate. Adding to this complexity is the variegated linguistic landscape in foreign countries, where language nuances and complexities in legal terminologies can pose additional challenges in screening processes.

Real-time Screening

Real-time screening of donors against AML and sanction lists is vital for promptly identifying potential risks. However, delays may arise when organizations fail to conduct these checks in real-time, compromising their ability to promptly identify and address potential risks.

Case Study:

The report, "The Adverse Impact of Counter Terrorism Laws on Human Rights Defenders and FATF Compliance in India," carried out by the American Bar Association Center for Human Rights, critically examines India's Anti-Money Laundering/Counter Financial Terrorism regime in relation to FATF guidelines. Focusing on three pivotal laws within India's counter-terrorism framework and delving into five specific cases involving non-profit organizations and human rights defenders, the study exposes the misuse of counter-terrorism financing laws to target defenders of rights. This misuse has led to the expansion of ambiguous laws, undermining fundamental procedural safeguards for defendants. The enforcement process relies on arbitrary allegations and inconsistent evidence, resulting in punitive measures such as prolonged pretrial detention and repeated denial of bail.⁴

Comprehensive Risk Mitigation Strategy

Addressing these pain points requires a combination of advanced technology solutions, regular training for staff involved in screening processes, and a commitment to staying informed about regulatory changes.

In this regard, a dual approach encompassing risk analysis and a risk-based approach concerning donor screening provides a framework for tackling these issues effectively.

Risk Analysis

While non-profit organizations often maintain positive relationships with donors, partner organizations, and beneficiaries, the existence of practical risks cannot be ignored. Without thorough donor screening, NPOs can inadvertently become conduits for terrorist financing and other crimes. Therefore, a primary risk analysis is imperative to ensure that donors' intentions are transparent, mitigating the potential for illicit purposes.

Risk-Based Approach:

Recognizing the diverse nature of risks in specific circumstances, considering the activities undertaken by the NPO, and understanding how and where these activities occur underscore the importance of NPOs comprehending the terrorist financing and money laundering risks they encounter. Adopting a risk-based approach enables NPOs to tailor their mitigation measures according to the unique risk landscape they face.

4. (2017, November 9). Retrieved February 9, 2024, from https://www.americanbar.org/content/dam/aba/administrative/human_rights/justice-defenders/india-fatf-report.pdf

The Role of Technology in Implementing Risk-Based Approach and Risk Analysis

In money laundering risk analysis, both PEP screening and adverse media screening are crucial for constructing a comprehensive risk profile.

Within the context of risk analysis, some NPOs have opted for a self-regulatory approach. This entails the development and implementation of frameworks and checklists designed to rigorously ensure that they have fulfilled their due diligence obligations.

Self-regulation in the context of risk analysis involves NPOs proactively establishing their own guidelines and criteria for assessing and managing potential risks. This approach is often driven by a commitment to ethical practices, transparency, and accountability within the organization's operations.

To facilitate this self-regulatory process, NPOs create comprehensive frameworks that outline the principles and standards guiding their risk analysis procedures. These frameworks typically encompass various aspects, such as financial integrity, governance, compliance with legal requirements, and adherence to ethical standards.

Additionally, NPOs often design checklists that serve as practical tools to systematically assess and monitor their activities. These checklists are tailored to the specific risks associated with the organization's mission and operations. They enable NPOs to methodically evaluate factors such as donor relationships, project implementation, and overall organizational performance.

Additionally, NPOs often design checklists that serve as practical tools to systematically assess and monitor their activities. These checklists are tailored to the specific risks associated with the organization's mission and operations. They enable NPOs to methodically evaluate factors such as donor relationships, project implementation, and overall organizational performance.



Standards and Initiatives Developed by NPO Sector (FATF)⁵

Standard or Initiative	Developing Organisation(s)
Principles of Conduct in Disaster Response Programmes	International Red Cross and Red Crescent Movement
The Do No Harm Handbook: The Framework for Analysing the Impact of Assistance on Conflict	Collaborative for Development Action, Inc.; CDA Collaborative Learning Projects
Private Voluntary Organization (PVO) Standards	InterAction
Humanitarian Accountability Partnership Standard	Humanitarian Accountability Partnership
Preventing Corruption in Humanitarian Operations Handbook of Good Practices	Transparency International
Humanitarian Charter and Minimum Standards in Humanitarian Response	The Sphere Project
Evaluation and Learning Activities	Active Learning Network for Accountability and Performance in Humanitarian Action
Cycle of Collective Learning	Group URD
Emergency Capacity Building Project	Interagency Working Group on Emergency Capacity
People in Aid Code	People in Aid
Muslim Charity Forum	Human Appeal International; Human Relief Foundation; Islamic Relief; Muslim Aid; and Muslim Hands.

5. <https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Risk-of-terrorist-abuse-in-non-profit-organisations.pdf.coredownload.pdf>

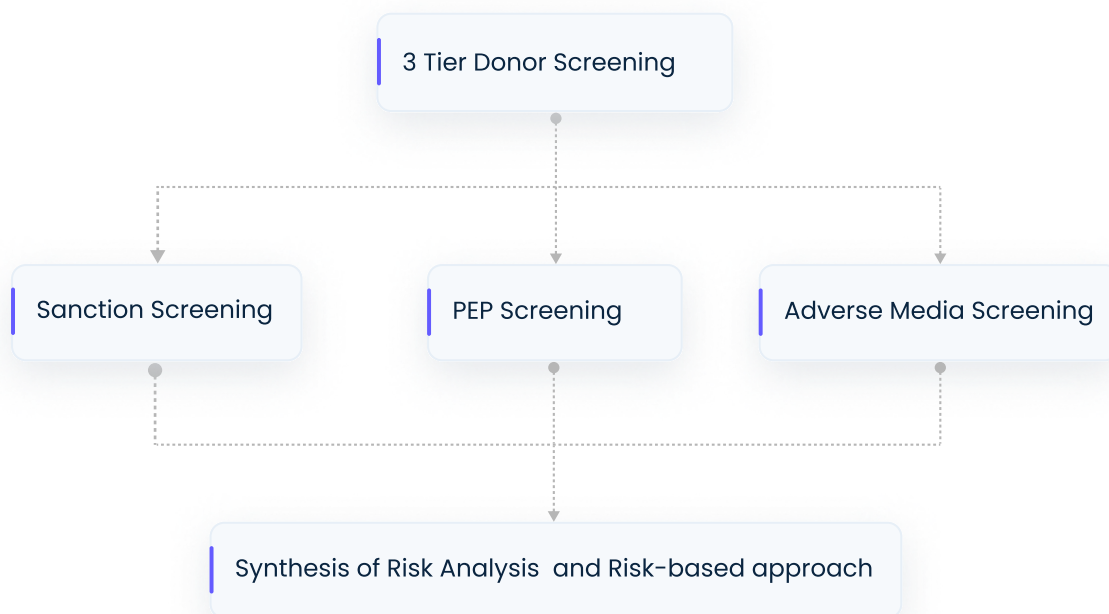
INEE Minimum Standards Handbook	International Network for Education in Emergencies
Enhancing Learning and Research in Humanitarian Assistance	Save the Children UK; Institute Bioforce; RedR; FrontlineSMS
Assessments and Monitoring Activities	Central Bureau on Fundraising
Peacebuilding Evaluation System	Alliance for Peacebuilding

Having stated that, in terms of risk-based approach, having continuously updated data that is readily available and secure is essential, in addition to incorporating PEP screening and adverse media screening.

What should be your plan of action?

Considering your next steps?

AML Watcher integrates the two approaches (risk analysis and risk-based approach) through a 3-Tier Donor Screening for Improved Efficiency. How does it accomplish this? It does so by combining three types of screening:



Add this after the flowchart: Our commitment is to streamline your donor screening process, providing a genuine and effective solution for navigating the complexities of regulatory obligations.



Turn Insights into Strategy

Get in touch for more information:



info@amlwatcher.com



amlwatcher.com